United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

75-1004

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P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI and JOSEPH SCANSAROLI,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF ON BEHALF OF PEAT, MARWICK, MITCHELL & CO., *AMICUS CURIAE*

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April 9, 1975

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The convictions appealed from ascribe criminality to professional judgments reached concerning:

(i) the inclusion by NSMC in its unaudited nine-months financial statements of the sales, costs and income effects attributable to a written commitment by Eastern Airlines to purchase services from NSMC; and

(ii) the need in a reconciliation footnote to NSMC's audited restated financial statements for previous years (the accuracy of which statements was not the subject of the indictment and which had been restated principally to reflect the effects of later corporate acquisitions) of explicit disclosure that previously

reported sales, costs and income effects attributable to certain commitments had subsequently been written off and that a previously recorded tax reserve charged against income had been unnecessary.

These judgments, like any of the judgments all professionals are called upon to make, might have been correct, innocently mistaken, negligently mistaken, recklessly mistaken or, finally, criminally wrong—the accountants were charged here with having "willfully and knowingly" made or caused to be made "false or misleading" statements with respect to "material facts".

For the jury properly to assess where these judgments lay on this scale required meaningful instruction by the trial court. As *amicus curiae*, Peat, Marwick, Mitchell & Co. submitted that the jury's verdict may not be sustained since the jury was not instructed either (i) concerning the different responsibilities of, and more particularly the different procedures followed by, an independent accountant in connection with audited and unaudited financial statements or (ii) that it should consider whether the accountant's professional judgment of immateriality, even if erroneous in objective terms, was honestly made.

Argument

1. The response on behalf of the Government with respect to the first point grudgingly concedes that the responsibilities of an independent accountant are different with respect to unaudited financial statements—that there is "some difference between responsibility for an audit and for a review" (Gov't Br. 55n). It also concedes that, apart from the words "audited" and "unaudited" themselves, the jury was never instructed con-

cerning this lesser responsibility and the concomitant inapplicability of audit procedures.

Having so conceded, counsel for the Government attempts to excuse the absence of a meaningful instruction by asserting that we did not state what the instruction should have been (Gov't Br. 53). This argument is a sham.

We stressed that "prejudicial confusion in the minds of the jurors was inescapable" in the absence of an instruction that the *audit* step of obtaining confirmations from customers of NSMC was not required in connection with *unaudited* figures, since there had been much testimony "concerning allegedly inadequate confirmations in connection with the 1968 audit and the confirmation procedures to be followed in connection with the 1969 audit" (PMM Br. 2-3).* We pointed out that this prejudice was "aggravated by the trial court's instruction with respect to 'reckless disregard'" (PMM Br. 3n). It was critical that the jury be instructed that audit procedures were not required to be followed in connection with NSMC's unaudited nine-months financial statements.

2. An equally disingenuous response (Gov't Br. 59-61) is made to the second point that the trial court failed to put to the jury the question of the culpability of the professional judgment that the written-off commitments and tax error need not be disclosed as such in the reconciliation footnote. The trial court did charge concerning objective materiality, which is an essential and preliminary question. But the trial court did not charge that subjective knowledge

* The confusion concerning the necessity of employing audit procedures evidently was not limited to the jury since the government is even now arguing that the Eastern commitment should have been "checked with Eastern" (Gov't Br. 31).

of materiality was an element of criminal culpability under the statute and circumstances here involved.*

In compelling contrast to the trial court's instructions here is the portion of Judge Mansfield's charge in *Simon* quoted by Government counsel just two pages earlier in a different section of their brief (Gov't Br. 57-58). Judge Mansfield put to that jury the question of "whether [the accountants] acted in good faith and on the mistaken assumption that netting might be a possibility."

The reliance (Govt. Br. 60) placed by Government counsel upon *United States* v. *Feola*, —— U.S. ——, 43 U.S.L.W. 4404 (March 19, 1975), is an imposition upon this Court. That case held that a defendant's knowledge of the status as a federal officer of the object of an assault is not an element of the crime, 18 U.S.C. § 111, or the crime of conspiracy to commit such an assault. In contrast to the assault statute which says nothing of knowledge, Section

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* The Government's contention (Gov't Br. 59) that this argument "flies in the face" of this Court's identification of "materiality" and "culpability" as distinct concepts in *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1974), misperceives the entire point of the argument. The Government emphasizes the wrong aspect of *Chris-Craft*, focusing only on its holding relating to a standard of objective materiality. We have not argued for the elimination of an objective standard of materiality, but rather, that if that standard is met, the jury in determining culpability must then consider the different question of whether a professional judgment to the contrary was made in good faith or bad faith. In terms of *mens rea*, was the error innocent or guilty? Thus our argument was addressed to the question of culpability, which we submit, under the circumstances of this case, cannot be meaningfully determined without considering defendants' state of mind with respect to materiality. The decision in *Chris-Craft* is in total accord with this argument. 480 F.2d at 363. The Government's misperception of which aspect *Chris-Craft* is relevant may explain its misplaced reliance upon another quotation from *Simon* (Gov't Br. 60). The quoted statement relates only to the effect to be given to expert testimony concerning objective materiality. It has nothing to do with the question of culpability.

32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a), specifically requires a knowing act.* *Feola* has nothing to do with the case before this Court where culpable knowledge is the essence of the offense.**

Government counsel seeks to justify the elimination of the question of *mens rea* from the jury's consideration by question-begging of the worst sort—by characterizing the omission of information judged to be immaterial as "purposeful, deliberate lies" (Gov't Br. 60). In any context where a professional plays some part in the summarization of events—whether in notes to financial statements or in the description of a company's business in a registration statement authored by a lawyer—judgments are made to include and to exclude particular data depending upon their perceived significance or insignificance. A judgment may be objectively erroneous, but it is not *ipso facto* a "purposeful, deliberate lie". Whether the judgment was made in good faith, as Judge Mansfield charged in *Simon,* is a different and crucial question.

As we have pointed out (PMM Br. 7, 7n**), the submission of this question to the jury was mandated not only by the statute and professional judgment here involved, but

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* Section 2.02(4) of the A.L.I. Model Penal Code (1961) provides:

> "When the law defining an offense prescribes the kind of culpability that is sufficient for the commission of an offense, without distinguishing among the material elements thereof, such provision shall apply to all the material elements of the offense, unless a contrary purpose plainly appears."

** The Government also relies (Gov't Br. 60) on *United States* v. *Schwartz,* 464 F.2d 499 (2d Cir. 1972), *cert. denied,* 409 U.S. 1009 (1973) despite the fact that *Schwartz* did not arise under the willful and knowing misstatement of material fact provision of Section 32(a) here involved, which indeed this Court elided from its quotation of Section 32(a) in the *Schwartz* opinion, 464 F.2d at 509. No issue of materiality or knowledge thereof was involved in *Schwartz.*

also, and very specifically, by Rule 3-02 of the Commission's Regulation S-X, which provides that an amount "need not be separately set forth" if it is "not material", and Section 23(a) of the 1934 Act, which provides that liability may not be imposed under the Act for any act "done or omitted in good faith in conformity with any rule or regulation of the Commission . . . ." No response is made by Government counsel to this point.

The question of whether the judgment of immateriality was made in good faith was not put to the jury here. The ambiguous and scattered sentences from the charge cited by Government counsel (Gov't Br. 60-61) could not begin to erase the pervasive impact of the trial court's detailed instruction concerning objective materiality which again is quoted only two pages earlier in a different section of the Government's brief (Gov't Br. 58-59) and which begins:

> "I want to define here for you what the law means about material facts." *

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* In the different context of the point that materiality must be determined in the light of the financial statements as a whole, counsel for the Government argues with reference to the trial court's detailed instruction concerning objective materiality that: "This lengthy prelude to the single sentence defendants complain of surely gave it a different coloring from the one they now ascribe to it." (Gov't Br. 59). Equally as "surely" the trial court's instruction as to objective materiality gave a "different coloring" to the sentences relied upon by Government counsel to suggest that in some obscure fashion the jury was instructed to consider whether the judgment of immateriality had been made in good faith.

CONCLUSION

Prejudicial confusion in the minds of the jurors was inescapable since the jury was not instructed that audit procedures were not required to be followed with respect to the nine-months unaudited figures. Plain error was committed when the jury was not instructed to consider whether the judgment of immateriality with respect to the reconciliation footnote was made in good faith.

We submit that for these and the other reasons detailed in the briefs on behalf of Mr. Natelli and Mr. Scansaroli and on behalf of the American Institute of Certified Public Accountants as *amicus curiae*, the convictions of Mr. Natelli and Mr. Scansaroli should be reversed and the indictment as to them dismissed.

Dated: New York, New York
April 9, 1975

Respectfully submitted,

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UNITED STATES COURT OF APPEALS

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UNITED STATES OF AMERICA, :

Appellee, : Docket No. 75-1004

-against- : AFFIDAVIT OF SERVICE

ANTHONY M. NATELLI and JOSEPH SCANSAROLI, :

Appellants. :

- x

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

ROBERT R. CAWTHRA, being duly sworn, deposes and says:

1. I am over the age of 18 years and not a party to this action.

2. On the 9th day of April, 1975, I served two copies of the Reply Brief of Peat, Marwick, Mitchell as amicus curiae, together with one copy of Peat, Marwick, Mitchell & Co's Notice of Motion upon:

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by causing true and correct copies to be hand delivered to their offices at the above-mentioned addresses.

Robert R Cawthra

Sworn to before me this
9th day of April, 1975

John Nicol
Notary Public

JOHN NICOL
Notary Public, State of New York
No. 60 2639500
Qualified in Westchester County
Certificate filed in New York County
Commission Expires March 30, 1977